China in a Changing World

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Thursday, 26 April, 2012
Developing world fared best out of the financial crisis

*The Economist, 18 August 2011*

**Real GDP per person**

04 2007 to 02 2011, % change

<table>
<thead>
<tr>
<th>Country</th>
<th>% Change</th>
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<tr>
<td>China</td>
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<td>Ireland*</td>
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</tbody>
</table>

Sources: Economist Intelligence Unit; Haver Analytics; IMF; JPMorgan; The Economist

*Q2 2011 estimate*
World Bank - Global middle-class > x3, from 430 m in 2000 to 1.2 billion in 2030 (or from 7.6% of world’s population to >16%); 93% from developing countries, especially China and India, up from 56% in 2000

Trade rapidly growing amongst emerging markets. Heart of the global production chain, China now the largest trading partner of more and more countries including Japan, India and Brazil.
The Tide is turning East

- National Intelligence Council Report *Project 2025*:
  - US leadership **capacity weakening** (EU fractious)
  - **W to E, N to S** - BRICS + ME - China’s dramatic growth + Beijing Consensus
  - New alliances + power groups + spheres of influence e.g. ASEAN + 3, SCO v UN, IMF, WB; G20> G8; China in Africa; China + ME

- **China** to overtake US by **2027/8**; *Turkey only behind France and Korea but still 14th by 2050* (Goldman Sachs); **Beijing Consensus** > Washington Consensus

- Emerging Markets lead contributors to world growth
  – China 27% v US 21%: DCs15% v US/EU@23% world GDP

- Joint BRICS “Development bank” > WB
Beginning of a new Era?

- Jim O’Neill, Goldman Sachs – *China to overtake US by 2027; China > Brazil + Russia + India*: 47% larger by 2015; BRIC > G7 by 2032; China + BRIC collectively much faster growth during trajectory
- **But lower capital productivity?** - June 2010 Federal Reserve Bank of Minneapolis study, starting from a low base and thanks to vibrant private sector, total factor productivity growth in China remained fairly high in the past decade; rate of return in both the state-owned and the private sectors increasing substantially. However, this may not last indefinitely.
- **China’s growth so far driven by imported proprietary technology.** Still way behind world's top league in science and innovation except in limited range of fields e.g. life sciences. No home-grown Chinese Nobel laureate scientist. Dearth of international Chinese brands. Huge challenges in resource and ecological constraints, social inequalities and rising aspirations of growing middle-class before aging population profile kicks in within a couple of decades.
- **India yet to overcome** bureaucracy, corruption, youth unemployment, and inadequate infrastructure
- **Ecological constraints and Malthus** + Climate Change, food and energy scarcity including water
- **West still far ahead in commanding heights** of global businesses including commercial aircraft industries, finance, and the world’s top brands. (*Who Are We? Who Are They? The Real Facts of a Globalized Chimerica*, brief for US-China Business Council, Peter Nolan, director of the China Big Business Program at Cambridge University, summer 2011)
Brave new world conceivable?

• By 2050, according to Goldman Sachs – Order of world’s top ten economies: China ($70 trillion), US (about $38 trillion), India (~ =US), Brazil (~> $10 trillion), Mexico (~< $10 trillion), Russia, Indonesia, Japan, United Kingdom, and Germany (about $5 trillion). Only four of the G7 to remain on this list.

• Except the US, the other three G7 countries, Japan, UK, and Germany, would have fallen to the bottom of the list.

• The combined economic weight of the six so-called Emerging and Growth-leading Economies (EAGLE), the E6, would be over two and half times more than the remaining G4.

• E6 would have soared well above the G7 to rule the world’s economy.

• Shakespeare - a tide in the affairs of men. The tide seems to have turned. In the fullness of time, how would the tide change again?
The epoch of mega urban-regions

(State of the World's Cities 2010-2011, UN Report)

- **Global urbanization** to jump from 50% to **70% by 2050**
- **40 Mega Urban Regions** = 14% world population; 66% world economy; 85% innovation; **top 25 cities** = 50% world’s wealth
- **Top five Mega Regions**:
  1. **HK - SZ –GZ** (120m)
  2. **Nagoya-Osaka-Kyoto-Kobe** (60m by 2015)
  3. **Rio de Janeiro -Sao Paulo** (43m)
  4. **West Africa linking Nigeria, Benin, Togo and Ghana**
  5. **Mumbai and New Delhi**

(Preparing for China’s Urban Billion, MGI, 3/2008)

- **1 b urbanites by 2030**, + **350 m in 221 cities** @ > 1 m population (EU=35)
- **15 super-cities** @ > 25 m population
- **11 hub-and-spoke conurbations** @ > 60 m population
Largest and Fastest Urbanization in Human History (1)

- MGI Report “Preparing for China’s Urban Billion”, 01.03.09
  - 350 m more urbanites > whole of US
  - 1 b to live in China’s cities by 2030
  - 221 cities =>@1 m v 35 in Europe today
  - 5 b sq metres of roads will be paved
  - 170 mass transit systems will be built
  - 40 b sq metres of floor space in 5 m buildings
  - 50,000 skyscrapers = building 10 New York Cities
  - China’s GDP will have multiplied 5 times

- 6 more for a total of 8 mega-cities (> 10 m population); 9 more for a total of 15 big cities (population 5 – 10 m); 55 more for a total of 115 medium-sized cities (population over 1.5 - 5 m); 163 more for a total of 280 small cities (population 0.5 – 1.5 m); and 72 more for a total of 521 big towns (population up to 0.5 m).

- 35 second-tier cities in 17 provinces collectively account for 16% of China’s population but represent 36% total GDP (China Britain Business Council Report, August 2008).

- 54% of urban GDP to be generated by 900 smaller cities by 2025, where 70% of China’s population is expected to live.

- Past 10 years, nearly 50% GDP growth from urban fixed investment to realize aim of quadrupling Y2000 GDP@ by 2020 = 20% of global GDP growth during this period.
China becomes *predominantly urban* (WSJ, 18.01.2012). 51.27% of 1.35 b people live in urban areas, total urban population 690.8 m.

**World’s largest mega-region – PRD** dynamic city nexus of manufacturing and services radiating from Hong Kong – Shenzhen – Guangzhou – total population 120 m – *State of the World’s Cities 2010/11, UN Habitat*

**Ning-Hu-Hang Delta Region** 宁沪杭三角区 (1.4% of area but 27.05% of industrial output) linking Shanghai, Nanjing, Hangzhou, Wuxi, Suzhou, Ningbo, Changzhou and Nantong.

**Bohai Rim** - Beijing-Tianjing-Hebei Nexus (Jing-Jin-Ji 京津冀) + *Binhai New Area Development Zone* industry and ecological belt linking Yanshan 燕山 + Taihangshan 太行山 Mountain ranges circling BJ and Tianjin

**Integrated economic region of 6 central provinces** of Shanxi, Henan, Anhui, Hubei, Hunan, and Jiangxi - driven by four major city clusters - Wuhan (capital of Hubei); Zhongyuan City Cluster centering on Zhengzhou (capital of Henan); the Chang-Zhu-Tan 长株潭‘golden triangle’ of Changsha (capital of Hunan); and the Wanjiang City Belt 皖江城市带 centerng on Hefei (capital of Anhui).

**Northeast Region** - Dalian and Shenyang (Liaoning Province), Changchun (Jilin Province), Harbin and Daqing (Heilongjiang Province) - Harbin-Daqing-Qiqihar Industrial Corridor 哈大齐工业走廊 for petrochemicals, energy, autos, electronics, medicine and food by 2020.

**Southwest Region - Chongqing**, world’s largest provincial-level municipality – population over 30 m, home to China’s giant iron, steel, auto, and other heavy industries - planned 10-m-ton refinery to process crude oil sourced worldwide through new pipeline from Myanmar via Kuming, Yunnan province. Nearby Three Gorges Dam is world’s largest hydro-electric power station.

**Northwest Region - Ordos, Inner Mongolia** dating back to the times of Ghengis Khan (1206-1227 CE). endowed with natural treasures of coal (proven reserve of 149.6 b tonnes low-sulphur ‘clean coal’, 1/6 of China’s total), kaolin (top-grade proven reserve of 6.5 b tonnes), natural gas (proven reserve of 878.8 bcm) and abundance of sheep producing top-quality cashmere – images of brand new but empty urban centres for “China shorters”
Urban productivity, sustainability or urban divide?

- China’s urbanization drive to (a) solve the “migrant” and “hukou” problem; (b) grow a middle-class society with systemic economic, social and political transformation.

- Increasing ‘urban productivity’ decreases public spending by 2.5% of GDP, reduces CO2 and SO2 emissions by 35%, + halves the water pollution.

- But cities may become hotbeds of urban divide in income, space, opportunities, and basic livelihood of food, shelter, health and education. Poor air quality, inadequate potable water, acid rain, desertification, toxic industrial discharges, CO2 and SO2 emissions and other ecological risks. Global challenge of building “intelligent” and “eco-cities”.

- As of 2009, 40 eco-cities being developed in China, including "4 smart-grid pilot cities, 21 LED-street-light cities, 13 electric-vehicle cities (Economist, 22 February 2012) Sino-Singapore Tianjin Eco-City in partnership with World Bank completion delayed to 2020
Rise of the emerging middle class

(Euromonitor International, 29 March, 2010)

- **Average @ consumer expenditure** in EMs to increase from **$4,381 in 2010 to $6,490 by 2020**

- **EM households with annual disposable income $5,000-15,000** to increase from **104m in 2000 to 331 m 2010**

- Of which 31.7% in China, 14.6% in India and 35.7% in Indonesia (*46.2% in China, 41.1% in India and 58.3% in Indonesia in 2020*)

- Advanced EMs - **Brazil, Poland, Mexico and Saudi Arabia** + secondary EMs e.g. Rest of Asia, Russia, Romania, Kazakhstan saw fastest growth 2000-10; > 50% such households by 2010;

- **Asia accounts for** 62.2% from 32.8% in 2000; to rise to **79.6% by 2020** with **China and India = 306 m** of 488 m households within the income band

- **Share of EMs and DCs in world GDP in PPP expected > advanced economies by 2014** (IMF)
China’s Massive Middle Class

• National Bureau of Statistics – **RMB60,000 – 500,000.** (x2.5 to adjust to PPP). From 23% (~300 m) to grow to 50% of population (~700 m) by 2025. (The Chinese Dream, Bestseller Press, 2010)

• 2010 - lower middle class RMB 25,001 to 40,000 > class below. 2015, “mass affluent” RMB100,001 to 200,000 - from 9.8% of total in 2005 to 36.4% by 2025. 2020, upper middle class RMB 40,001 to 100,000 > lower middle class.

• “Global affluent’ with annual household income over RMB 200,000 from 1.6 m in 2008 to > 4.4 million by 2015. < only US, Japan, and UK. Despite slowdown, wealthy households likely to grow 16 % p.a. for the next 5-7 years. (McKinsey Quarterly, 2006 Special Edition)

• 80 % under 45 years of age, v 30 % in the US and 19 % in Japan.

• 120 million of 350 m internet users **shop online.** (The Chinese Dream)

• Yum! Brands opened **500 new restaurants** in China **in 2010** including one new KFC every day.

• **China > India as largest gold market**, World Gold Council, Jan 2012

• **13.6 million cars sold in China, 2009,** surpassing the US

• **One million US$ millionaires** (Hurun Wealth Report, April, 2011). World Luxury Association’s 2010-2011 annual report - China to be the world’s largest market for luxury brands in 2012.

• **Consumption 36% of GDP** (v 71% in US); **150 m live at a dollar a day or less.** (China Development Research Foundation, 2012). But **Credit Suisse expects China to displace US in global consumption growth by 2014.**
The era of transnational high speed rail

- China to build 3 transnational high-speed (av 215 miles/hr) rail links by 2025:
  - (a) Heilongjiang – Siberia – W Europe – BJ/London in 2 days (SCMP 8 March 2010)
  - (b) Urumqi to Kazakhstan, Uzbekistan, Turkmenistan, Germany?
  - (c) Kunming to SE Asia (Vietnam, Thailand, Myanmar, Malaysia, Singapore)

- Eurasian Land Bridge (‘New Silk Road’) links Chinese port city of Lianyungang (near Shanghai) and Kazakhstan, connecting Central Asia including Iran + possibly Turkey

- All links to China’s massive transportation infrastructure – world’s largest railway expansion since 19th C (all-high-speed system target being advanced to 2012 from 2020) + 2nd largest national expressway system surpassing US interstate
China’s rapid world-connecting mobility

- **In 2011,** 85,000 km intercity freeway system **exceeds the US** interstate highway system by 10,000 km.
- World’s **largest rail expansion since 19th C.** From 86,000 km in 2009 to **110,000 km. 2012** (second to US 260,000 km). World’s fastest (average 350 km/hr) and longest **high-speed rail network.** Beijing to most provincial capitals < 8 hrs.
- 1,956 km-long, state-of-the-art **Qinghai-Tibet Railway** traversing land 4,000 m high.
- **97 new airports by 2020** (82% population <90 min to airport).
- World’s **largest deep-water Yangshan port** linked by longest 32-km sea-bridge to Shanghai; Qingdao to build largest iron-ore handling terminal by 2030
- **China inc HK - 6 of world’s top 8 container ports:** SH, Singapore, HK, SZ, Busan, Ningbo, GZ, Qingdao, Dubai, Rotterdam
- Already half-completed “**Modern Silk Road**” or **Asia –Europe Continental Land Bridge,** or **Euro-Asia Land Bridge,** 10,900-km rail-link traversing 40 countries linking Shanghai’s Lianyungang - through Gansu (Lanzhou), Xinjiang, to Rotterdam (freight) and London (passenger). Interest of transit countries, including Turkey, being canvassed. China to provide capital subject to payments in resource-contracts
- **Dec 2011 – 513 m internet users;** March 2012 – **one billion mobile phone subscribers**
Age of energy, water and food security

- **Three Billion New Capitalists**, Clyde Prestowitz
- **China 8% of world crude oil demand** to generate 20 m extra jobs p.a. v US 25%; each only 3% of world oil reserve
- **China** – 9% world’s arable land to support 20% of world population
- **Wheat, rice and corn 37% less by 2\textsuperscript{nd} of 21\textsuperscript{st} C** – food shortage 5-10% within 20 yrs (China’s joint deptal report, March 2007)
- Energy-rich but food-scare countries **quest for overseas food supply** – MENA e.g. Libya, Ukraine; Saudi Arabia to invest in agriculture and livestock overseas; Chinese Ministry of Agriculture - land in Brazil for soybean production, investment in agriculture in Africa, the world’s largest Food Basket
- **Security of supply and transportation routes** – diplomacy, choke points and territorial disputes
- **Geo-economics and geopolitics** - Russia, Iran, Venezuela, petrodollars, Scramble for Africa
- **Arctic** (*Trausti Valsson, U of Iceland*) – Davis + Denmark Straits, GIUK, Bering Strait, Kamchatka, Sea of Okhotsk, Aleutian Islands, safe Canadian Northern Passage + cornucopia of resources
Russia-China-Iran energy nexus

(Asia Times, Jan 8, 2010)

• 182-km Dauletabad-Sarakhs-Khangiran **pipeline** inaugurated in Jan 2010 – connects Iran's Caspian with Turkmenistan's vast gas field

• **Turkmenistan has committed its entire gas exports to China, Russia and Iran.** Turkmen gas annual capacity of 20bcm enables Tehran to free own southern gas production for export

• **Russia, Iran and Turkmenistan hold the world’s 1st, 2nd, and 4th largest gas reserves.** China is consumer par excellence.

• Moscow and Ashgabat agreed to build jointly an E-W pipeline connecting all Turkmen gas fields to a single network for Russia, Iran and China to draw from.

• Tehran claims to have a deal with Ankara to transport **Turkmen gas to Turkey via the existing 2,577 km pipeline connecting Tabriz in NW Iran with Ankara.**

• **Russia's South Stream and North Stream intend to supply gas to N & S Europe. Stumbling blocks for North Stream cleared** as Denmark (in October), Finland and Sweden (in November) and Germany (in December) approved the project from the environmental angle. Construction to commence in Spring 2010.

• **Pipeline inaugurated** by President Hu on December 14, 2009 marks milestone in Russo-China energy links. Oil terminal near Nakhodka in Russia's FE inaugurated by Prime Minister Putin on December 27, 2009 will service a $22-b oil pipeline from the **new fields in E Siberia leading to China and the Asia-Pacific markets.**

• Russian to position as Europe’s No. 1 energy provider. **Counterweight against US-backed Nabucco project.** in the Caspian which seeks to bypass Russia, elbow out China and isolate Iran.
A New China in Africa

• China’s % share of Africa’s export of selected commodities

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<td>24.3</td>
<td>53.8</td>
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• China’s ‘Grand Plan for Africa’ (Martyn Davies, University of Stellenbosch)

  – **Mining Hub** – Chambishi, Zambia
  – **Indian Ocean Trading Hub** – Mauritius
  – **East Africa Logistics Hub** – Dar-es-Salaam, Tanzania
  – **West Africa Manufacturing/Assembly Hub** - Nigeria
  – **MENA Regional Export Hub** – Egypt near Suez Canal
The world going Green

- **Drivers** – Energy security; Climate Change; Business opportunities

- **Exploring new horizons:**
  - *Solar*: thin film; computerised concentrators
  - *Re-inventing bio-fuels*: enzymes + algae
  - *Ocean energy*: onshore, offshore, tidal
  - Water to extract geo-thermal heat energy
  - *Underground Coal Gasification* (UCG)
  - *Domestic* energy-efficient appliances and measures
  - *Cars of the Future* (e.g. BYD e-6 capable of 420 km on single charge)
  - *Artificial photosynthesis* farms
  - *Harnessing the sky* - wind + solar
  - *Nuclear fusion* (ITER project)
  - ‘Staircase to Heaven’ – CO2 removal

- **China** invests $200b to increase *renewable energies* from to **15% by 2020** (IEA); **leading in hydro, solar, wind, electric cars, and new eco-cities**
Coming Renaissance of the Silk Road

- **China** (now 1/2 of US oil demand) > US to become top oil importer from ME
- **Saudi Arabia** already sells >1m bpd to China (20% of China’s demand) since 2008/9 > US
- **King Abdullah** first visited China when ascending throne 2006; helped build China’s strategic oil reserves; recent assurances of back-up supply in case of unforeseen events; explosion of bilateral trade
- Gulf accounts for 40% of China’s oil imports (Iran 13%)
- 1,200 km pipeline from Kazakhstan to North Xinjiang
- **SCO** + India, Pakistan, Afghanistan, Iran, Turkey (Observers)
- Continuing interest in Iraqi oil potential (post US withdrawal scenario)
- Land-based transportation routes away from sea-based choke-points (Hormuz and Malacca Straits)
- Asia => 55% of total Gulf trade, + 30% p.a.
- Trade between China and Gulf doubled 2000-08
- **Gulf petrodollars into China** estimated $250b 2008-13 (JL McGregor, BJ-based consultancy)
- **Saudi Aramco** in $5b refinery complex in Fujian; **Jazan Economic City** set up in Riyadh to attract Asian capital (e.g. Chalco (aluminium)); **Dubai Ports** in container ports in Tianjian; listing of Chinese companies in Abu Dhabi
China’s surging ODI

(Is there a China model of overseas direct investment?, Bijun Wang and Yiping Huang, ANU and Peking University, April 12th, 2011)

• ODI increased from $2.85 b in 2003 to $56.53 b in 2009, + 55 % p.a., expanding global share from 0.45 to 5.1 %.

• In 2009, China largest developing country investor + 5th largest investor after US, France, Japan, Germany, up from 12th in 2008.

• In 2010, China's ODI surged 36.3 % to $59 b v FDI growing only 17.4 % to $105.7 b. ODI in US increased by 297 % + in EU by 81.4 %. China ODI poised to overtake FDI in coming decade.

• Most Chinese ODI is in service industry, including commercial services, finance, retail and wholesale.

• Desirous for advanced technology, brands, management skills and stable supply of resources. 2006-8 ODI in primary sector = 18.7 % v 7.84% (developed countries) and 8.83% (developing countries)

• Manufacturing ODI = 4.7% v 24.1% (developed) and 15% (developing) but rising wages and economic upgrading will see China moving more labour and energy –intensive manufacturing to other lower-cost countries, especially Africa

• In 2011, ODI in 680 enterprises first 2 months + 13.1 % to $5.27 b (Yao Jian, Ministry of Commerce spokesman, 23 March, 2011)
transactions now dominate Chinese spending. A related feature in both Heritage and official Chinese data is the prominence of large, centrally controlled state entities as investors.

Countries. The Heritage series is far more useful than Chinese data in determining what country destinations are ascendant. The Ministry of Commerce did not publish its breakdown of 2009 investment until November 2010. Even then, Hong Kong accounted for 63 percent of outbound investment because the PRC treats Hong Kong as a separate customs territory. In fact, investment passes through Hong Kong heading elsewhere. The Heritage series tracks spending to its final destination.

The main event in 2010 was a flood of money into the Western Hemisphere outside the U.S., led by Brazil but also featuring Canada, Argentina, and Ecuador. Almost an afterthought in 2008, this is

Source: Heritage Foundation dataset, China’s Outward Investment: Non-bond Transactions over $100 million, from January 2003 to December 2010, available upon request from The Heritage Foundation.

Map 1 • WM 3133 heritage.org

China’s Worldwide Reach
The United States is second to Australia in drawing Chinese non-bond investment.

<table>
<thead>
<tr>
<th>Region</th>
<th>Amount (in billions of dollars)</th>
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<tr>
<td>U.S.</td>
<td>$28.1</td>
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<tr>
<td>Europe</td>
<td>$34.8</td>
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<tr>
<td>West Asia</td>
<td>$45.2</td>
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<td>$31.6</td>
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<td>Western Hemisphere</td>
<td>$61.7</td>
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<tr>
<td>Sub-Saharan Africa</td>
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<td>Arab World</td>
<td>$37.1</td>
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<tr>
<td>Australia</td>
<td>$34.0</td>
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</tbody>
</table>

Source: Heritage Foundation dataset, China’s Outward Investment: Non-bond Transactions over $100 million, from January 2003 to December 2010, available upon request from The Heritage Foundation.

Map 1 • WM 3133 heritage.org

Outward foreign direct investment (OFDI) flows and stocks from BRIC countries
Dynamics of China’s ODI


• China’s “Going Global” strategy established 1999. World’s 12th largest investor 2008 to 5th largest 2009.

• Still, China, including Hong Kong and Macau, just 6% of global ODI stock today. Many less than $10 m @. Plenty of upside room.

• Aims (1) natural resources; (2) export (3) overseas R&D for advanced technologies, managerial skills and professionals; and (4) M & As to enhance international competitiveness (NDRC + China EXIM Bank, October 2004)

• 2003, SAFE and MOFCOM allowed foreign investments of less than $3 m (up from $1m) to be approved at the provincial level

• SAFE abolished quotas on FX for ODI, 1 July, 2006

• Dec 2008, commercial bank loans allowed for cross-border M & A.

• In 2009, SOEs = 67.6% of ODI; private enterprises = 0.6% (Lenovo, TCL, and Beida Jade Bird (all listed on stock-exchanges) owned by regional governments of BJ, SH, and GD)


• State Organs in ODI - State-owned Assets Supervision and Administration Commission (SASAC), created in 2003 to manage and transform large SOEs with a share of resulting profits; SAFE; MOFCOM; CBRC; State banks, including China EXIM Bank, China Development Bank and China Export & Credit Insurance Corporation

• China Investment Corporation (CIC), $332 b sovereign wealth fund
China’s ODI objectives and obstacles


Energy and Minerals

• In 2002, CNOOC bought Indonesian assets of Spain’s Repsol YPF for $593 m, followed by purchase in March of 5% stake in Northwest Shelf natural gas field off the coast of Australia for $320 m; and 12.5% stake in the Indonesian offshore Tangguh Gas field from BP in October for $275 m.

• In 2009, Shanghai Baosteel acquired 15% ($240.5 m) stake in Aquila Resources in Australia; Yanzhou Coal Mining, China’s 4th largest coal producer, bought Australia’s Felix Resources Ltd. for $2.9 b; while SINOPEC acquired Swiss oil explorer Addax for $7.24 b for high-potential oil blocks in West Africa and Iraq.

Technologies

• In 1988, Shougang purchased 70% of California-based Mesta Engineering and Design Inc. with access to high-tech design capability in steel-rolling and casting.

• In 2001, Holley Group, a Hangzhou maker of electricity meters, bought mobile-phone design and software operations of Philips Semiconductor.

• 2002, Huayi Group of Shanghai paid $20 m for the battery-making assets of Moltech Power Systems, a bankrupt outfit in Gainesville, Florida.

Global Brands (to grow “National Champions”)

• In 2005, Lenovo acquired IBM’s personal computer division.

• In 2005, Nanjing Automotive acquired British MG Rover.

• In 2010, Geely Automotive, one of China’s biggest, acquired Ford Motor's Volvo for $1.8 b.

Concerns of national security

• Have blocked a number of Chinese ODIs e.g. CNOOC for UNOCAL (2005); Chinalco bid to double stake in Rio Tinto (2009); Chinese telecom-equipment makers Huawei and ZTE bid for US Sprint Nextel Corp (2010).

• China now becoming more adverse to high-profile deals
Other less apparent objectives

Investment in “tax havens”
- In 2009, Hong Kong, Cayman Islands, and British Virgin Islands collectively received 79% China’s net, nonfinancial FDI outflows.
- Most for “round-tripping” According U.S. Department of State’s China Investment Climate survey, - includes investments from corporate HQs in OECD economies, Taiwan, and, largely, China itself.

Political hedge for property rights protection

Neutralizing trade barriers
- (BBC, 2002) Cotton spinning mill in Mauritius for African Growth and Opportunities Act duty-free access to U.S. market.
- In 2002, TCL bought Schneider but kept production in Europe to avoid European quotas on Chinese TV imports

Foreign relations especially Africa
- (a) UN (b) One China Policy (c) Resources (d) Profits (China’s Post-Cold War Strategy in Africa, Joshua Eisenman, 2007)
- Resources, Infrastructure, Agri-business, Consumer, SEZs
- FOCAC formed 2003 after 1st Head of State summit 2000
- China and Africa trade grew from $18.6 b in 2003 to $106.8 b in 2008. Expected by 2013 to surpass 50% of $1 trillion African aid over past 60 years. Expected by 2015 to exceed $300 b (Bloomberg, 22 Feb, 2011)
- Packaged finance: concessional loans, sellers + buyer’s credits + bank guarantees by MOFCOM and EximBank (1/2 seller’s credit 1/3 guarantees) v World Bank almost 100% loans.
Getting out of the US Dollar Trap

- **The USD Trap** (*Paul Krugman*, Nobel Prize laureate)

- **Zhou Xiaochuan**, Governor, PBOC hinted at unofficial **USD peg being ‘temporary’** (FT 6.03.2010)

- **Three Ways out of the USD** (*Nomura*, 5 March 2010)
  
  (1) **Incremental Diversification** out of US Treasuries (Dec 2009 foreign-held UST dropped $53b of which $34.2 due to China)

  (2) **Reducing current account surplus** (gradual RMB appreciation, more imports, more consumption, **outward FDI** (inc SWF) especially in resources e.g.

  - *Chinalco* $19.5 b in Rio Tinto
  - $25 b loan for 15 m tons crude for 20 yrs with Russia’s Rosneft and Transneft
  - $10 b loan for oil deal with Kazakhstan
  - $10 b Sinopec deal with Petrobras (20.5.2009)

  (3) **RMB internationalization** as a global reserve currency e

  - **Currency swaps** (> $120 b)
  - Promoting **RMB as settlement currency** (HK + Asian countries)
  - Issuing **RMB bonds** (initially in HK)
New Pilot Scheme to allow RMB for international settlements

Series of MOFCOM, SAFE, and PBoC circulars since January 2011 (Mayer Brown JSM, 21.07.2011)

(Caution: Professional legal advice should be sought in all circumstances).

- **July 2009 Circular No. 10**, issued by six PRC ministries and commissions; **June 2010 Circular No. 186** issued by Ministry of Finance; **6 January 2011 Circular No. 1** issued by PBoC; **25 February 2011 Circular No. 72** issued by MOFCOM; **7 April 2011 Circular No. 38** issued by SAFE; **3 June 2011 Circular No 145** issued by PBoC.

- **Subject to the provisions of these circulars**, including approval by NDRC, MOFCOM, or PBoC on a case by case basis. Cross-border RMB funds may now be used for (a) payments by foreign investors for new or additional capital contributions of FIEs; (b) acquisitions by foreign investors of shares/equity interests or assets of existing companies in the PRC; (c) inbound shareholder loans by foreign investors to their FIE subsidiaries; (d) outbound shareholder loans by PRC domestic investors to their offshore subsidiaries; and (e) payments by PRC domestic investors for their ODI project expenses.

- Circular 145 states that only RMB proceeds “legitimately raised” by foreign investors may be used for capital account transactions. The following are likely to meet the legitimacy test as prior PRC governmental approvals would normally be required for raising or obtaining such RMB funds:
  - **Onshore RMB funds deposited by foreign individuals and institutions in RMB settlement accounts** of a PRC bank for settlement of cross-border trade and service payments;
  - **Proceeds from offshore RMB-denominated bond issuances, such as “Dim Sum Bonds” and Synthetic Bonds issued in Hong Kong**;
  - **RMB-denominated dividends distributed by H share companies in Hong Kong**;
  - **RMB-denominated A share liquidation proceeds and dividends** repatriated to foreign shareholders;
  - **RMB-denominated shareholder loans by PRC domestic investors to their offshore subsidiaries**;
  - **RMB-denominated proceeds received by foreign governments or foreign companies from ODI projects undertaken by PRC domestic investors**; and
  - **RMB-denominated IPO proceeds raised in Hong Kong**.
Channels for inflow and outflow of Cross-border RMB funds

(Mayer Brown JSM, 21.07.2011)
(Caution: Professional legal advice should be sought in all circumstances)

Channels for inflows for an FDI transaction
- Onshore agent bank of an overseas bank participating in the cross-border RMB pilot scheme;
- Overseas clearing bank designated for the pilot scheme e.g. Bank of China (Hong Kong); or
- Settlement account opened by the foreign investor with a PRC domestic bank where the balance of such settlement account is “ring-fenced” exclusively for settlement of cross-border transactions.

Channels for outflows
- A PRC domestic investor undertaking an ODI project or providing shareholder loans to its offshore subsidiaries may only remit RMB funds required for such transactions through its onshore RMB bank account.
- Profits from an ODI project and repayment of principals and interest on any RMB denominated shareholder loans must be registered with SAFE.
- Such retained RMB may serve as channel for outflow of RMB funds for ODI projects with approval of SAFE.
Ideas for RMB-linked investments through the private sector

(Central banks may consider using investment vehicles similarly to SAFE using CIC as a Sovereign Wealth Fund)

- Purchase of ‘dim sum bonds’ denominated in Chinese yuan and issued in Hong Kong
- Purchase of shares listed overseas by China’s main enterprises, including H Shares in Hong Kong
- QFII -for investing in selected “A Shares” in China
- Purchase of RMB through the China Foreign Exchange Trade System (CFETS) for FIEs in China
- Currency swaps
- M & A of China enterprises in China
- Joint M & A with Chinese ODI (under pilot scheme allowing RMB for international settlements)
- Investment in suppliers /exporters to China
- Investment in home/foreign leading brands/technologies/financial institutions/resource enterprises/retailers (what China needs) and selling an equity stake to Chinese ODI
- Forming partnership (joint investment vehicles) with CIC for China’s “Going Out” strategy, using the reimbursement/fee receipt route to receive RMB for settlements
- Helping China to issue RMB-denominated bonds in overseas markets (e.g. London and New York)
- FDIs in Five Year Plan 2011-15 priority-areas e.g. new technologies, high-end manufacturing, life sciences, bio-technology, nano-technology, aircraft production, R & D, financial services, green energies, new materials, conservation, deep-water drilling technologies, eco-business, green cars, agriculture, healthcare, education, creative industries, retail chains, famous Chinese brands, tourism and hospitality, shipping and transportation
- Joint investments with China in Africa e.g. resources, infrastructure projects, agriculture and food processing, labour-intensive production and distribution, mobile banking, telecommunications, China’s African SEZs
- Joint investments with China in home/overseas infrastructure including regional high-speed rail, port facilities, utilities, smart grids, etc.
- Special “Swap Fund” with China for joint bilateral investments in each other’s country and overseas
China’s economy in 2012

(cf. China Economic Focus, British Embassy, Beijing)

• NPC/CPPCC Premier Wen revised average growth to 7.5% for 12th Year Plan 2011-15. Chinese Academy of Sciences – 2012 growth 8.5% (9.2%2011)

• Inflation down to 3.2% in February

• Property prices in 70 cities falling moderately (not too serious as mortgage ratio low)

• RMB stable, expected to appreciate by 3-4% p.a., in line with need to grow domestic consumption

• On 13 February, raft of measures to support SME exporters, including tax cuts, export credits, and simplified procedures

• On 18 February, bank RRR cut by 0.5% to a range of 18.5%-20%, still robust

• PMI rebounded to 51% in February 2012

• Data consistent with “Soft Landing”
China 2030

- Imperative blueprint to escape the so-called *Middle Income Trap* ~@$8,000 (China still $5,184 (2011)

Prescriptions –
- (a) redefining *revenue and responsibilities between central and local authorities* to avoid forcing the latter resorting to land appropriation as main source of revenue;
- (b) unlocking the *inefficient capital accumulated by large state-owned enterprises* and promoting the competition and innovation of the private sector;
- (c) implementing the State Council decision in 2011 of *guaranteeing a decent standard of living for the people* with access to public services including health care, education and housing by 2020;
- (d) *unblocking the "hukou" (household registration) system* which deprives migrant workers of access to local social provisions and acts as a hindrance to greater national social mobility;
- (e) using the rising middle class as a catalyst for *improved governance, standards of services, and the empowerment of civil society*;
- (f) *liberalizing the financial system* to achieve higher total factor productivity;
- (g) pushing ahead with the *internationalization and eventual capital-account convertibility of the RMB* with a view to its use as an international reserve currency;
- (i) delivering a *comprehensive economic, social and environmental agenda to achieve a green economy and society by 2030* (e.g. by capitalizing on a voluntary "cap-and-trade" scheme and introducing green standards in the massive government procurement program); and
- (j) playing a *more proactive role as a responsible stakeholder*, helping to shape the global order commensurate with the growing size and influence of China's economy.

*Doing more of the same is no option:* over a million millionaires but 170 m people still live under $1.25 a day. Body of university graduates to swell by 200 m over the next two decades > US workforce. By 2030, 2/3 urbanized, from 50% at present. Owing to demographics, China to "grow old before getting rich".
Thank you

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